STATEMENT OF
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1. Introduction

Good afternoon, Chairman Grassley and Members of the Committee. I am Mark Warshawsky, Director of Research at the TIAA-CREF Institute, the financial and economic research and education arm of TIAA-CREF. Founded in 1918, TIAA-CREF is a nonprofit financial services company and the nation's largest private retirement system, providing defined contribution pension plans to almost 2 million workers in the nonprofit education and research sectors and making retirement income payments to almost 300,000 annuitants.

I am pleased to testify at this hearing, which provides a good opportunity to review research and information relevant to understanding some of the implications for women of setting up individual accounts under various Social Security reform proposals. Because Social Security currently serves as the foundation of Americans' retirement plans, it is in everyone's best interest to take on the crucial task of fashioning an efficient and fair Social Security program as soon as possible. Understanding the operational details of individual accounts and the impact that they can have on groups such as women in an essential step in evaluating proposals to add individual accounts to Social Security. Your leadership in conducting this hearing should be commended.

There are a number of features in the current Social Security system that address the special retirement security needs facing women. Similar types of benefit features are available in employer-sponsored retirement plans. As you requested, I will focus my remarks on the life expectancy of women and how life annuities can alleviate the concern that women will outlive their retirement assets. I will also address design features such as unisex pricing of annuities, joint-and-survivor benefits, and indexing inflation, and how these concepts might be carried over to individual accounts under Social Security reform. I base my testimony on the results of several research studies, including some I have helped conduct over the years, as well as the experience of TIAA-CREF.

II. The Advantages of Life Annuities, especially for Women

As we all know, women live longer than men. According to the Social Security Administration, Office of the Actuary, in 1998, a woman age 62 could expect to live to age 84, while a 62-year-old man could expect to live to only age 80. According to the projection of the Social Security Actuary, by the year 2020, at the height of the retirement of the baby boom generation, women age 62 are expected to live to age 85.

The life expectancy statistics I have just cited are expectations, that is, averages. If you knew your exact date of death, you could schedule a draw down of pension and personal assets at retirement so that the flow depleted those assets just at the moment of death. In reality, however, almost everyone has considerable uncertainty about length of life. This is true for people at the time of retirement, and it is especially so for longer-lived women. According to the Social Security Actuary, a woman age 62 currently has a 25 percent chance that she will live until age 92, and a 10 percent chance that she will live until age 97.

To avoid the problem of poverty at the end of life, one might conserve one's assets, and draw only small amounts so as to self-insure against the risk of longevity. But this tactic only spreads poverty over one's lifetime rather than postponing it to the end of life. There must be a better way of solving the problem of using one's assets to finance consumption over an uncertain lifetime.

And there is. It is called the life annuity. In its most basic form, an annuity, whether issued by a life insurance company, an employer pension plan, or a government program, pools people together, and pays out a higher flow of income to each participant for his or her entire lifetime than if each individual were left to his or her own devices. The risk-sharing features implicit in the life annuity are especially critical to women, with their longer life expectancies, their greater uncertainty about length of life, and, according to some studies, their higher aversion to risk. These considerations argue strongly that the life annuity should be an important or even mandated component of any individual accounts established under Social Security reform.

How does the annuity issuer accomplish this magic of maximizing income, while eliminating risk, for the plan participants? By pooling the resources of the population and paying more, *in total, to the longer-lived than to the shorter-lived. It is important to note that the system can only work with some element of mandatory participation or pre-commitment. That is, if an individual knew his or her life expectancy to be shorter than the population average, that individual would be less likely to participate voluntarily in the life annuity program or would want to be excused from the arrangement after entering. If there were enough individuals with this knowledge who were able to act by refusing to participate or withdrawing, the remaining individuals 'in the pool would be longer-lived than the general population, and the annuity issuer would be forced to raise prices or cut income flows. This process, called adverse selection by actuaries and economists, in the extreme can destroy the viability of the life annuity principle.

Mandatory annuitization can help out with another potential problem, called moral hazard by economists and other social scientists, which can be particularly severe in public programs. More specifically, allowing individuals to take lump-sum withdrawals from their accounts upon retirement creates the risk that some individuals would deplete these assets early. In the worse case, they might become impoverished and be forced to rely on public welfare programs. If the public welfare program was generous enough, some otherwise prudent individuals might be tempted to take greater risks or spend larger sums, knowing the welfare program was there as a safety net. Mandatory annuitization helps avoid this unfortunate scenario and relieves pressure on the social safety net.

An annuitization requirement would be like the current Social Security system, in which lump-sum withdrawals are not available and retirement benefits are uniformly computed at a certain age. Yet among the advantages of individual accounts are their abilities to reflect individual preferences and their allowance for the accumulation of wealth for various purposes. These purposes include extraordinary expenditures, such as uninsured health and long-term care needs, or transfers to children and grandchildren.

Women are particularly exposed to the risk of long-term care. They typically survive their husbands and therefore have no spousal assistance available as the need for home health care or nursing care arises in later life. If individual accounts are set up, thought should be given to allowing some flexibility 'in withdrawing assets from the accounts in specific circumstances. Ideas might 'include an option to postpone the age of mandatory annuitization to age 70. Another might be an exemption from mandatory annuitization if the account size is sufficient to produce retirement 'income flows above certain minimum poverty levels. Widespread coverage of the population by private long-term care and Medigap insurance would lessen the need for cash withdrawal flexibility.

III. Annuity pricing and women

It is important to explain at the outset of our technical discussion that annuities provided from defined benefit plans (such as Social Security) and annuities purchased with funds accumulated in defined contribution or individual account plans generally operate quite differently. In a defined benefit plan, most extra annuity benefits provided, such as disability benefits or indexation for inflation, are *added* at the cost of the provider to the base level of benefits and do not reduce them. By contrast, in individual account plans, extra features such as inflation indexation or joint-and-survivor benefits must be paid for by the annuitant and therefore *reduce* annuity benefits otherwise payable, given a fixed accumulation of assets. Of course, economically the two modes of operation are equivalent, particularly if the sponsor of the defined benefit plan calculates what it can afford, including the extra benefits likely to be paid, and sets the base benefit level accordingly. But in the perception of plan participants, the two modes of operation may appear quite different, particularly when the context is converting part of Social Security's currently defined benefits to an individual account set-up.

Because women are, on average, longer-lived than men, insurance companies, absent any legal impediments, will price single life annuities issued to women at a higher premium than single life annuities issued to men. Indeed, in the market for single-premium immediate life annuities issued to individuals, women are currently charged about 10 percent more for a single life annuity than men. This extra charge is more than justified b differences in life expectancies Since the Norris case was decided by the Supreme from defined contribution plans the Thrift Saving Plan for federal government employees and TIAA-CREF plans for workers in education and research must be provided on the same rate basis to women as to men.

Because the Social Security defined benefit formula uses the same unisex pricing principles currently in force for employer-sponsored pension plans, it seems fair to require that life annuities paid out from accumulations in individual accounts which may be established under Social Security reform be paid on a unisex basis. The same principles of equality and social justice should apply to all retirement accounts. When a male plan participant, who takes a distribution from his retirement plan, rolls it over to an IRA and then purchases a tax-qualified individual single life annuity priced on a sex-distinct basis, he circumvents the intent of the law and the Supreme Court's decision. This practice creates the theoretical possibility that adverse selection will occur. The remaining group of (largely female) plan participants will therefore receive lower income flows. Of course, if annuitization were mandatory for individual accounts, the possibility of adverse selection arising from unisex pricing would be largely eliminated.

A final consideration on annuity pricing and women's concerns: Administrative expenses are largely fixed costs, that is, the same costs are incurred in establishing and servicing an individual account whether the account size is large or small. Women, who typically earn less than men and whose attachment to the labor force is more intermittent, will likely build up smaller account balances. *If* the providers of the individual accounts (including the issuers of life annuities when account balances are converted at retirement) were allowed to charge fixed dollar fees, women would be adversely affected. If, however, the plan providers covered their expenses as a certain percentage of assets, as most providers currently do in the retirement plan business, and the same percentage were applied to accounts of all sizes, then women would fare as well as men.

Under a joint-and-survivor annuity, monthly benefits are paid to the annuitant over his or her lifetime *and* the lifetime of the beneficiary, usually a spouse. The monthly benefit is smaller than the monthly amount from a single-life annuity because payments are being paid over two lifetimes rather than one. Originally under ERISA, a retiring worker was not required to elect a joint-and-survivor option from a pension plan nor even to tell his or her spouse what benefit payment method was selected. Because the joint-and-survivor payment appeared smaller, some plan participants were selecting the single-life annuity option, leaving their spouses (usually wives) with no benefit if the participant predeceased the spouse.

To combat this problem, Congress enacted in the Retirement Equity Act (REA) of 1984 a requirement that a plan participant who elected any form of payment other than a joint-and-survivor annuity must obtain the spouse's written, notarized consent. [IRAs, simplified employer pensions, and state and local government retirement plans, however, are not covered by this requirement.] A joint-and-survivor annuity "qualified" under this law must provide 'income to the surviving spouse in an amount equal to at least one-half of the income payable when the participant and spouse are both alive.

The reasons that compelled Congress to enact REA for pension plans should probably lead to some type of joint-and-survivor annuity requirement for individual accounts established under Social Security reform. Moreover, in the context of individual accounts, serious consideration should be given to increasing the required level of income payable to the survivor to two-thirds so as to mimic the Social Security benefit formula, which recognizes some partial but incomplete economies of scale in the cost of living for a couple.

It is less clear whether an election, with consent, to opt out of the joint-and-survivor form should be made available in a system of individual Social Security accounts. Arguments favoring a strict joint-and-survivor requirement with no opt-out election include the following considerations. Spousal consent is a burdensome and sometimes confusing process, and if it were desired to lower administrative costs and reduce the need for participant decisions, the joint-and-survivor payment method could be made the only allowable method. It is also possible that even though some spouses give their consent to the selection of a single-life annuity, they do not understand what they are giving up. Finally, a strict joint-and-survivor requirement would also reduce the scope for adverse selection which might possibly occur under unisex pricing of annuities. With unisex pricing of annuities and the election allowed to opt out of the joint-and-survivor payment method, it is likely that married women will choose a single life annuity and married men will choose a joint-and-survivor annuity. This behavior could thereby lead to an equilibrium situation where the mortality of longer-lived women is more pronounced in the remaining population pool causing benefit levels to be reduced.

There are other considerations, however, which argue for allowing the holders of the individual accounts to choose whether or not to take a joint-and-survivor payment method, provided, of course, spousal consent is obtained. Variables such as the relative health of the account holders, the relative account sizes among the couple, the availability of other retirement assets, and other needs such as supporting special children, all argue for some flexibility in this choice. These same needs for flexibility also argue for the allowance of guaranteed periods whereby a designated beneficiary (even other than the spouse) will continue to receive monthly payments after the death of the annuitant[s] until the period (typically ten or twenty years) ends. Allowing guarantee periods of payments also reduces the scope for adverse selection.

Now I would like to share with you TIAA-CREF's successful experience with life annuities as the primary form of distribution from retirement plans. All TIAA-CREF plans provide for a variety of annuity income options. The plan sponsor-determined rules in about 85 percent of TIAA-CREF plans also allow participants to choose whether to take retirement benefits 'in lump sums for cash or transfers, either fully partially. In addition, most TIAA-CREF plans allow for distributions as systematic withdrawals, interest only, or, after the later of retirement or age 70-1/2, the minimum required to avoid the imposition of an Internal Revenue Code-imposed 50 percent excise tax. Even with this wide array of distribution options, when TIAA-CREF participants settle their account at retirement, almost two-thirds -- 60 percent of males and almost 70 percent of females -- choose a life annuity of some type.

Among TIAA-CREF participants selecting a life annuity, men were much more likely to choose a joint-and-survivor annuity than were women. Half of the male annuitants selected a full benefit to a survivor and about a quarter chose a two-third or half benefit to a survivor. By contrast, more than two thirds of the female annuitants chose a single-life annuity, with the remainder selecting the joint-and survivor form. There has been a strong trend since 1984 for all annuitants, but especially men, to select the joint-and-survivor payment form. About 80 percent of male annuitants and 75 percent of females chose some type of guaranteed period.

V. Inflation-indexation

The central purpose of a retirement plan, whether publicly or privately sponsored, whether defined benefit or defined contribution, is to provide the plan participant and his or her spouse with income in retirement to finance their consumption needs. A logical corollary of this purpose is that the flow of income in retirement should increase over time to reflect, at least in part and approximately, increases in the cost of living. Although price inflation is currently low, in the past inflation has ravaged the purchasing power of the fixed income flows of pensioners, and there is always a risk that inflation could again rise to high rates. Again because of their longer life expectancies, women are especially exposed to the risk of inflation during retirement. Therefore, in any system of individual accounts established under Social Security reform, women would particularly desire and need gradual 'increases in annuity benefits over their lifetime.

Social Security benefits are now automatically adjusted to reflect changes in the cost of living and many pension plans and individual annuities also provide adjustments increasing income flows over the lifetime of the plan participant. In fact TIAA-CREF invented the variable life annuity 1952 precisely for the purpose of allowing its annuitants to receive income increases during retirement resulting from (anticipated) stock price appreciation. Although there is little evidence that stock prices reflect inflation, at least in the short-run, and stocks are certainly volatile, annuitants in equity-based variable accounts, over most historical time periods, have received impressive increases in incomes. These annuitants, although retired from the labor force, are able to participate 'in the general performance of the economy, by maintaining equity investments which have performed well in the United States and other developed countries over most recent historical periods.

Another more stable payment method intended to increase benefits over the annuitant's lifetime, implemented at TIAA-CREF in 1982, is called the graded method. Under this approach, instead of being entirely paid out, dividends are reinvested and used to buy additional future income. Although income under this method is not able to reflect unexpected sharp spikes in inflation, studies have shown that purchasing power is preserved, indeed enhanced, over most historical periods through 1995. Both variable annuities and the graded payment method are widely utilized by TIAA-CREF participants settling their accounts.

There are still other ways that individual annuities 'in the United States provide income flows reflective of inflation. TIAA-CREF offers an Inflation-Linked Bond Account that variable annuitants can use as an underlying investment. Because this Account invests almost exclusively in U.S. Treasury Inflation-Protected Securities, if inflation were to spike, the value of the account would increase, and variable annuitants would receive increases in income reflective of the increased inflation rate. The federal government employees' Thrift Savings Plan offers an increasing payment annuity. In this annuity, the amount of the monthly payment can change each year on the anniversary of its issuance. The amount of the change is based on the change in the CPI although increases cannot exceed 3 percent per year. Neither of these annuities has yet achieved much popularity, although it must be recalled that the inflationary environment is currently quite benign. I should finally mention that inflation-linked annuities are currently available in the United Kingdom where they enjoy an active market and are priced competitively.

VI. Other retirement related reforms that would help women

Social Security, pensions, and personal savings will all have to contribute to provide resources to finance consumption during an ever-lengthening period of retirement. Recent studies have shown that both men and women of the baby boom generation currently are not putting enough resources aside to achieve this goal. As one looks to reform Social Security, it is equally important to seek improvements in laws and regulations that will encourage greater pension coverage for women and men. The bipartisan pension reform proposal that you, Mr. Chairman, and Senator Graham introduced last year and we hope will introduce this year will help achieve that goal. Especially important provisions of that bill include: increasing portability among plans, eliminating the 25 percent of compensation limit in Section 415 and the maximum exclusion allowance limit under Section 403(b), creating a catch-up election for workers over age 50, revising the minimum distribution rules, and changing the top heavy rules.

Because it has been the focus of some of my own research, let me elaborate a bit more on the need for reform in the minimum distribution rules. All forms of distribution from retirement plans, including lump-sum and systematic withdrawals, and life annuities, are governed by federal minimum distribution requirements. The requirements state that payments must start at least by the year following attainment of age 70-1/2 or retirement (whichever is later). IRA holders, as well as workers with pension plans from prior employers, however, must begin distributions after age 70-1/2, regardless of whether they are retired or not. Required distributions may continue periodically over the lives or life expectancies of the plan

participant and his or her designated beneficiary. These payments must be included in the plan

participant's taxable income; if they are not, the participant is subject to a confiscatory 50 percent penalty tax. If payments are made over life expectancy, the Code and regulations require that the life expectancy must be calculated using an IRS-determined unisex mortality table.

These requirements were put into place in 1962 to prevent Keogh plans from becoming vehicles for income and estate tax avoidance. At that time, age 70-1/2 was the life expectancy of men who were much more likely than women to utilize Keogh plans in the social and labor market conditions extant in 1962. While the original intent for, and structure of, the requirements may have been valid, the rules have become increasingly outmoded in today's labor market and social conditions. Life expectancies, especially for women, have increased dramatically, and women are now as likely to be covered by retirement plans as men.

The following changes to the minimum distribution requirements would treat women, as well as men, more fairly. Their cost, in terms of lost tax revenues to the federal government, is likely to be small.

- Change the required start date to the later of age 76 or retirement. The increased participation of women in the labor force, and increasing life expectancies for both men and women argue for the first change in the start for minimum distributions in almost 40 years.

- Update the mortality table used by the IRS. The Annuity 2000 table, recently put out of the Society of Actuaries, is the more accurate mortality table to use instead of the 1983 table now used by the IRS.

- For spousal survivors, allow minimum distributions to begin when the surviving spouse turns 76 rather than when the deceased participant would have turned age 76 (70-1/2 in current law). The current set of rules is particularly unfair to female survivors, who are usually younger than their husbands.

We thank you for your leadership on both Social Security and pension reform.